Before the
Administrative Hearing Commission
State of Missouri

SOUTHWESTERN BELL TELEPHONE COMPANY AS SUCCESSOR IN INTEREST TO SOUTHWESTERN BELL TEXAS HOLDINGS, INC.,	)	
Petitioners,	)	
vs.	)	No. 12-1576 RF
DIRECTOR OF REVENUE,	)	
Respondent.	)	

DECISION

Southwestern Bell Telephone Company ("Petitioner"), as the successor in interest to Southwestern Bell Texas Holdings, Inc. ("Holdings,"),[1] is not liable for the franchise tax assessed by the Director of Revenue .

Procedure

On August 21, 2012, Petitioner filed a complaint appealing the Director's assessments of Missouri corporation franchise tax for franchise tax periods 2003, 2004, and 2005. The Director filed an answer on September 21, 2012.

Petitioner filed a motion for summary decision with proposed findings of fact on June 10, 2013 ("the motion"). The Director filed a response and a cross-motion for summary decision

[1] In this decision, in accordance with the submitted uncontroverted facts, Petitioner is called "Holdings" when we discuss its corporate and operational history.

("the cross-motion"), with his own proposed findings of fact, on July 2, 2013. Petitioner filed a response to the cross-motion, including a response to the Director's proposed findings of fact, and a reply to the Director's response on August 14, 2013.

We held a conference call with the parties on September 13, 2013. The parties filed a joint supplemental stipulation of facts on October 7, 2013. The Director also filed an amended response to Petitioner's proposed findings of fact on the same date. Petitioner filed a response to the Director's revised statement of undisputed material facts on October 21, 2013.

Pursuant to 1 CSR 15-3.446(6)(A),[2] we may decide a motion for summary decision if a party establishes facts that entitle that party to a favorable decision and no party genuinely disputes such facts. Those facts may be established by stipulation, pleading of the adverse party, or other evidence admissible under the law. 1 CSR 15-3.446(6)(B). We make our findings of fact from the undisputed facts and the admissible evidence submitted.

Findings of Fact

1. During the 2003-2005 Missouri franchise tax periods ("tax periods"), Holdings was a Delaware corporation, with its commercial domicile located outside of Missouri. Its business address was 208 S. Akard St., Dallas, TX, 75202. On September 30, 2011, Holdings merged into Southwestern Bell Telephone Company, also a Delaware corporation.

Background

2. Southwestern Bell Telephone, LP ("LP"), was formed in Texas on December 30, 2001.

3. Prior to the formation of the limited partnership, Southwestern Bell Telephone Company (SWBT), Southwestern Bell Texas, Inc., and Southwestern Bell Telephone, LP, sought

[2] All references to "CSR" are to the Missouri Code of State Regulations, as current with amendments included in the Missouri Register through the most recent update.

approval from the Missouri Public Service Commission "to convert SWBT, through a series of transactions . . . from a Missouri corporation to a Texas limited partnership."

4. The applicants stated that the "purpose of this conversion is to achieve an overall tax savings," and "this conversion will have no effect on the tax revenues of the State of Missouri or its political subdivisions in which [SWBT's property is located] . . nor will the restructuring affect the ultimate owner of SWBT, which will continue to be owned by SBC Communications Inc. ("SBC")."[3]

5. The applicants also stated that after the conversion, the Texas limited partnership would apply for the fictitious name "Southwestern Bell Telephone Company" and the conversion "will be transparent to SWBT's Missouri customers."[4]

6. According to the application, the conversion of SWBT to a Texas limited partnership would be a complex reorganization that would include these steps: Holdings would be formed; Holdings would form and own 100% of a single-member limited liability company (LLC); Holdings would form a new Texas corporation (SWBT Texas), which would be owned 99% by Holdings and 1% by LLC; SWBT would merge with SWBT Texas, with SWBT Texas the surviving entity; SWBT Texas would convert to a Texas limited partnership (LP), with the general partner interest issued to LLC and the limited partnership interest issued to Holdings, in ownership percentages relative to the SWBT Texas stock ownership by LLC and Holdings.

7. SWBT filed Missouri corporation income tax returns from at least 1984 through 1998, and its income for 1999 through 2001 was included in Missouri consolidated income tax returns filed by its parent company, SBC Communications, Inc. ("Parent").

[3] October 12, 2001, filing with Missouri Public Service Commission, attached to Petitioner's answers to Respondent's first interrogatories, attached to Director's cross-motion.

[4] *Id.*

8. SWBT filed Missouri corporation franchise tax returns from at least 1975 through 2001.

9. SWBT's 2000 Missouri corporation franchise tax liability was $713,726 and its 2001 Missouri corporation franchise tax liability was $701,251.

10. LP's income for 2002, 2003 and 2004 was reported on its Parent's consolidated income tax returns under the name "Southwestern Bell Telephone LP," although in some documents for the 2002 income tax period, LP's name was incorrectly stated as "Southwestern Bell Telephone Company" and its FEIN was incorrectly stated.

Activities during the Tax Periods 2002-2005[5]

11. Holdings did not own hard assets.[6] Rather, it owned intangible equity interests in various entities. All of Holdings' business decisions were made in Texas where its officers and directors were located. Holdings, through those officers and directors, engaged in no activity in any state other than the state of Texas during the periods 2002-2005 ("tax periods") and at all other times.

12. During the tax periods:

a) Holdings did no business in Missouri, had no property or payroll in Missouri, and had no certificate of authority to do business in Missouri.

b) Holdings rendered no services to or for any person or entity in Missouri.

c) Holdings had no offices, employees, independent contractors, agents or other representatives in Missouri.

d) Holdings did not buy, sell or procure any property in Missouri.

[5] The franchise tax periods at issue are 2003, 2004, and 2005. The franchise tax is based on assets as of January 1 of a given year. Thus, the 2003 franchise tax, based on assets owned as of January 1, 2003, is, as a practical matter, based on the corporation's balance sheet as of December 31 of the preceding (2002) tax year. The preceding income tax year is, therefore, relevant to the franchise tax year and sometimes referred to in this decision.

[6] "Hard assets" are tangible assets such as real property, inventory, or tangible personal property.

e) Holdings did not buy, sell or procure any services in Missouri.

f) Holdings did not maintain any bank accounts at banks located in Missouri.

g) Holdings did not maintain its books or records in Missouri and made no management decisions in Missouri.

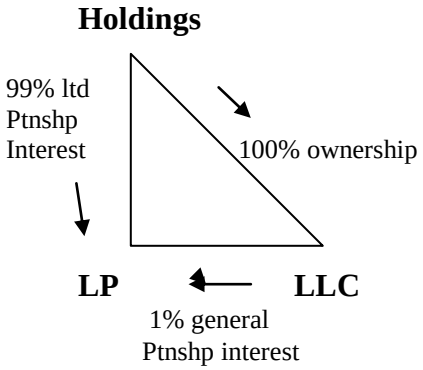
h) Holdings did not conduct any board meetings in Missouri.

i) Holdings filed no tax returns in Missouri, but was a part of a consolidated income tax return that its parent filed in Missouri.

13. During the tax periods, Holdings was a 99% limited partner in LP. LP provided landline telephone service in a number of states, including Missouri, during the tax periods.

14. The 1% general partner of LP was LLC. Holdings owned LLC during the tax periods. During the tax periods, LLC elected to be treated as a disregarded entity for federal income tax purposes.

15. To summarize, Holdings owned 100% of LLC. Holdings and LLC were the two partners in LP. Holdings held a 99% limited partnership interest, and LLC held a 1% general partnership interest, as illustrated below:



16. While Holdings owned a 99 % limited partnership interest in LP, LP's assets were not Holdings' assets. LP's limited partnership agreement provided at all relevant times that "[t]he legal title to the real and personal property or interest therein now or hereafter acquired by

the Partnership, shall be owned, held or operated by the Partnership, and no Partner, individually, shall have any ownership of such property."

17. While LLC owned a 1% limited partnership interest in LP, LP's assets were not LLC's assets.

18. While Holdings owned LLC, it did not own the assets of LLC.

Assessments and Final Decision

19. On August 10, 2007, the Director issued to Petitioner notices of deficiency of franchise tax for the tax periods.

20. On October 1, 2007, Petitioner timely protested the notices of deficiency.

21. In the Director's final decision, the Director states that his auditor properly determined that Holdings was subject to the Missouri franchise tax for the tax periods because it held the entire interest in LLC and LP. "The Director's auditor determined that [Holdings] was engaged in business in Missouri in 2003, 2004 and 2005, through its interest in [LP]."[7]

22. Neither Petitioner, nor LP, nor LLC filed Missouri corporation franchise tax returns for 2003, 2004 or 2005.

23. During the tax periods, Petitioner filed no income tax returns in Missouri, but Petitioner's income was included in consolidated federal income tax returns and consolidated Missouri income tax returns filed by Parent for income tax periods 2002, 2003 and 2004.

24. LP's income was also included in consolidated federal income tax returns and consolidated Missouri income tax returns filed by Parent for income tax periods 2002, 2003 and 2004.

[7] Director's final decision at 6 (attached to Petitioner's complaint).

Partnership Income 2002-04[8]

25. The balance sheets (Schedule L) and detail to those balance sheets that were included with Parent's 2002, 2003 and 2004 consolidated federal income tax returns reported assets at the end of the year for all members of the affiliated group, SBC Communications Inc. and Subsidiaries; the assets reported for the affiliated group (that is, the sum of the assets of all the members of the affiliated group), for Petitioner, and for LP are as follows:

Entity	2002	2003	2004
Affl. Grp. (total)	111,962,895,267	117,997,353,858	159,760,953,275
Petitioner	1,990	1,990	1,990
LP	17,277,355,556	18,744,355,556	17,494,439,391

26. LLC's assets are not reported separately on the affiliated group's balance sheet.

27. For each of these periods, Petitioner's assets of $1,990 were determined by subtracting the value of assets of entities that it held which were included as part of the consolidated income tax return; the subtraction was made in order to prevent the double counting of assets for apportionment purposes on the consolidated income tax returns.

28. Prior to that subtraction of assets, Petitioner's balance sheets for the end of 2003 and the end of 2004 reported the following assets (the figures for 2002 were not available):

	2003	2004
A/R-Oth-Affil-SWBell & Subs-SBC-MSI[9]	1,000	1,000
Investments in Affiliated Companies-Partnerships	4,411,015,117	4,020,825,290.77
Total	4,411,016,117	4,020,826,290.77

[8] In view of our decision that Petitioner is not liable for franchise tax during these years, we include findings of fact 25-31 solely for the convenience of a reviewing court.

[9] This abbreviation stands for accounts receivable from the Parent (SBC Communications, Inc.) to Petitioner (Holdings) upon the creation of Petitioner in exchange for the common stock of Petitioner.

29. The affiliated group's balance sheets for the relevant periods reported these assets for LP for 2002, 2003 and 2004 (relevant to the 2003, 2004 and 2005 franchise tax periods):

	2002	2003	2004
Cash	(70,656,331)	8,612,254	103,834,768
Net trade receivables	4,316,310,078	4,513,310,657	4,268,177,453
Inventories	1,327,981	(71,587)	1,462
Other current assets	107,037,144	56,708,115	62,018,677
Other investments	854,060	777,572	777,571
Net depreciable assets	12,237,677,758	13,440,962,482	12,363,786,239
Land	224,590,667	226,845,074	228,728,512
Net intangible assets	129,103,615	72,242,645	27,980,834
Other assets	331,110,584	425,611,115	439,133,875
Total assets	17,277,355,556	18,744,998,327	17,494,439,391

30. The liabilities reported on the balance sheets for LP are summarized as follows:

	2003	2004	2005
Liabilities (lines 16-21)[10]	11,441,833,377	12,609,831,952	13,666,069,196
Stockholders' equity (lines 22-25)[11]	5,835,522,179	6,135,166,375	3,828,370,195
Total	17,277,355,556	18,744,998,327	17,494,439,391

31. To determine Petitioner's total assets for each period, the Director's auditor added LP's stockholders' equity to the assets reported on Petitioner's balance sheet. He then computed Petitioner's franchise tax starting with those total assets and using items from LP's balance sheet in the apportionment computation. The tax computations are summarized as follows:

MO-FT Line No.		2003	2004	2005
2a.	Total assets	5,835,524,169	6,135,168,365	3,828,372,185
2b.	Investments/advances	0	0	0
2c.	Adjusted total assets	5,835,524,169	6,135,168,365	3,828,372,185
3a.	Accounts receivable-Missouri	679,650,828	732,542,480	666,486,813
	Everywhere	4,316,311,078	4,513,311,657	4,268,178,453
3b.	Inventories-Missouri	205,086	0	0
	Everywhere	1,327,981	0	1,462
3c.	Land and fixed assets-Missouri	1,973,049,719	2,170,315,479	1,994,186,757
	Everywhere	12,462,268,425	13,667,807,556	12,592,514,751

[10] These amounts include accounts payable; mortgages, notes, bonds payable under 1 year; other current liabilities; mortgages, notes, bonds payable over 1 year; and other liabilities.

[11] These amounts include capital stock; paid-in or capital surplus; and retained earnings-unappropriated.

3d.	Total allocated assets-Missouri	2,652,905,633	2,902,857,959	2,660,673,570
	Everywhere	16,779,907,484	18,181,119,213	16,860,694,666
4.	Missouri percentage	15.8100	15.9663	15.7803
5.	Missouri assets	922,596,371	979,559,387	604,128,616
7.	Tax	307,225	326,193	201,175

Conclusions of Law

We have jurisdiction over appeals of the Director's final decisions. Section 621.050.1.[12] Our duty in a tax case is not merely to review the Director's decision, but to find facts and determine the taxpayer's lawful tax liability for the period or transaction at issue by applying existing law to those facts. *J.C. Nichols Co. v. Director of Revenue,* 796 S.W.2d 16, 20-21 (Mo. banc 1990). Exclusions from tax are construed in favor of the taxpayer because all laws imposing a tax are strictly construed against the taxing authority in favor of the taxpayer. § 136.300.1; *American Healthcare Management, Inc. v. Director of Revenue,* 984 S.W.2d 496, 498 (Mo. banc 1999). However, Petitioner has the burden of proof. § 621.050.2.

The franchise tax is imposed by § 147.010, RSMo Supp. 2012:

> 1. For the transitional year defined in subsection 4 of this section and each taxable year beginning on or after January 1, 1980, but before January 1, 2000, every corporation organized pursuant to or subject to chapter 351 or pursuant to any other law of this state shall, in addition to all other fees and taxes now required or paid, pay an annual franchise tax to the state of Missouri equal to one-twentieth of one percent of the par value of its outstanding shares and surplus if its outstanding shares and surplus exceed two hundred thousand dollars, or if the outstanding shares of such corporation or any part thereof consist of shares without par value, then, in that event, for the purpose contained in this section, such shares shall be considered as having a value of five dollars per share unless the actual value of such shares exceeds five dollars per share, in which case the tax shall be levied and collected on the actual value and the surplus if the actual value and the surplus exceed two hundred thousand dollars. **If such corporation employs a part of its outstanding shares in business in another state or country, then such corporation shall pay an annual franchise tax equal to one-twentieth of one percent of its**

[12] Statutory citations are to the RSMo 2000 unless otherwise indicated.

> **outstanding shares and surplus employed in this state if its outstanding shares and surplus employed in this state exceed two hundred thousand dollars, and for the purposes of sections 147.010 to 147.120, such corporation shall be deemed to have employed in this state that proportion of its entire outstanding shares and surplus that its property and assets employed in this state bears to all its property and assets wherever located. A foreign corporation engaged in business in this state, whether pursuant to a certificate of authority issued pursuant to chapter 351 or not, shall be subject to this section.** Any corporation whose outstanding shares and surplus as calculated in this subsection does not exceed two hundred thousand dollars shall state that fact on the annual report form prescribed by the secretary of state. **For all taxable years beginning on or after January 1, 2000, but ending before December 31, 2009, the annual franchise tax shall be equal to one-thirtieth of one percent of the corporation's outstanding shares and surplus if the outstanding shares and surplus exceed one million dollars.** Any corporation whose outstanding shares and surplus do not exceed one million dollars shall state that fact on the annual report form prescribed by the director of revenue.

(Emphasis added). For the taxable years at issue in this case, the annual franchise tax is one-thirtieth of one percent of the corporation's outstanding shares and surplus. In the case of a corporation that employs a part of its outstanding shares in business in another state, the tax is imposed on the outstanding shares and surplus employed in this state if the outstanding shares and surplus exceed two hundred thousand dollars.

Petitioner is a Delaware corporation that is domiciled in Texas. It is a 99% limited partner in LP, a business entity that provides landline telephone service in Missouri. The 1% general partner of LP was LLC, which was wholly owned by Petitioner. In other words, directly or indirectly, Petitioner owned 100% of LP. The issue in this case is whether, for purposes of the franchise tax, Petitioner employed any of its outstanding shares and surplus in this state during the tax years at issue.

The Franchise Tax and Foreign Corporations

Few reported cases discuss the franchise tax, and only one – *Household Finance Corporation v. Robertson,* 364 S.W.2d 595 (Mo. banc 1963) – discusses the application of the franchise tax to a foreign corporation that does business in Missouri.

In *Household Finance,* the corporation appealed from an assessment by the Missouri State Tax Commission ("STC"). Household Finance Corporation ("HFC") was a Delaware corporation with its principal place of business in Chicago. It owned 17 local branch offices in Missouri and all of the capital stock of numerous subsidiaries, seven of which were Delaware corporations that were authorized to do business in Missouri.

HFC filed its 1958 franchise tax report reporting property and assets in Missouri consisting of $111,017.16 in cash; $12,231,403.87 in loans receivable; $75,167.27 in office furniture and fixtures; and $26,803.08 in "deferred charges." With the report, HFC filed a copy of its general balance sheet showing cash in the amount of $26,601.884.74; advances and capital stock in its subsidiaries of $261,333,611.36; loans to its seven subsidiaries operating in Missouri of $$4,563.132.00; and stock in the seven subsidiaries valued at $560,000.00.

Using the corporation's general balance sheet, the STC increased HFC's total Missouri assets, and thus the amount of its franchise tax liability. The STC did so by first fixing a ratio equal to the amount of loans receivable and tangible assets reported by HFC as part of its Missouri assets divided by the same items reported on HFC's general balance sheet. The STC then multiplied this percentage, .042812, by the entire amount of HFC's cash, wherever located. This produced an amount of $1,138,879.00 in cash employed in Missouri, rather than the $111,017.16 reported by HFC. The STC also added the amount of capital stock in HFC's Missouri-operating subsidiaries ($560,000.00) and the loans it made to those subsidiaries

($4,563,132.00) as assets of HFC in Missouri. HFC appealed the assessment, and the trial court granted summary judgment to it.

On appeal, the Supreme Court reversed the trial court's judgment in part. It first construed the word "surplus" as used in the phrase "outstanding shares and surplus" in § 147.010, RSMo 1959, as "the excess of gross assets over the par value of its outstanding shares without deduction of debts or liabilities." 364 S.W.2d at 601, *citing State ex rel. Marquette Hotel Investment Co. v. State Tax Commission,* 221 S.W.721, 722 (Mo. banc 1920). The Court also quoted *Marquette Hotel* on the nature of the franchise tax itself. "It is upon the franchise, we reiterate, that the statute here in question levies a tax. The extent of the *use* of the franchise is the basis for the computation of the tax." *Id.* The *Household Finance* court concluded that the franchise tax was intended to be measured "upon the basis of the amount of the shares of stock and surplus *used* in its business in Missouri." 364 S.W.2d at 601. The court interpreted the language of § 147.010 to mean "such corporation shall be deemed to have employed in this state that portion of its entire outstanding shares and surplus that its property and assets [*employed*] in this state bear to all its property and assets wherever located." *Id.* at 602 (bracketed phrase in original).

> To hold otherwise would enable all corporations, domestic and foreign, to employ in this state their cash on hand and *used in their authorized business in this state* without paying the corporation franchise tax as required by § 147.010 by the simple expedient of keeping such cash in another state and drawing thereon as their needs required. For example, can the statute mean that either a domestic or foreign corporation engaged in the business of making loans in St. Louis, Missouri, may avoid payment of a portion of the franchise tax imposed under § 147.010 merely by keeping the cash thus employed by it in East St. Louis, Illinois, and drawing thereon as its Missouri commitments required? We think it can not.

Id. at 602-03. The legislature later amended § 147.010 to be consistent with the court's interpretation.

Thus, under *Household Finance* and § 147.010, the franchise tax is imposed upon the property and assets a corporation *employs* – not holds – in this state. If this were the only controlling authority, we would find for the Director, because Petitioner clearly "employs" considerable assets in this state. But this case is complicated considerably by the fact that Petitioner employs those assets through a limited partnership. A further question – the issue in this case – is whether the assets of LP should be imputed to the Petitioner for purposes of franchise tax liability. The Petitioner argues they should not; the Director argues they should.

Petitioner's Arguments

The Petitioner argues that § 147.010 imposes the franchise tax only on corporations. While Petitioner is a corporation, the corporation employs almost no assets *owned by the corporation* in Missouri. The assets used to provide landline telephone service are owned by LP. Petitioner points out that the Director's regulations impute the assets of a subsidiary corporation to it for purposes of the franchise tax, but not those of a limited partnership. Regulation 12 CSR 10-9.200(2)(C) provides:

> Assets invested in or advanced to subsidiary *corporations* . . . are considered to be employed by the subsidiary. Any portion of a corporation's surplus so invested may be deducted from its tax base on line 2b of the franchise tax form, with the following conditions: a) The corporation claiming the deduction must own more than fifty percent (50%) of the voting stock of the subsidiary, and b) *The subsidiary must be a corporation.*

(Emphasis added). And, just as the statute imposing the franchise tax must be strictly construed against the Director, we must apply the same rule of construction when we interpret the Director's regulations. *State ex rel. Evans v. Brown Builders Elec. Co., Inc.,* 254 S.W.3d 31, 35 (Mo. banc 2008).

Nor, Petitioner argues, may we impute the assets of LP to Petitioner through Petitioner's ownership of LLC. An LLC that elects to be treated as a disregarded entity for federal income

tax purposes is also a disregarded entity for purposes of Chapters 143 (income tax), 144 (sales tax), and 288 (employment tax). § 347.187.2. But the statute makes no mention of Chapter 147 or the franchise tax. Thus, LLC is not a disregarded entity for franchise tax purposes, and Petitioner, as a member of LLC, has no interest in LLC's property. § 347.061.1.

Petitioner points us to a similar case from another state, *Utelcom, Inc. and Ucom, Inc. v. Bridges*, 77 So.3d 39 (La. Ct. App. 2011), construing similar facts under a similar law. LSA-R.S. 47:601 imposed a franchise tax on "every domestic corporation and every foreign corporation, exercising its charter, or qualified to do business or actually doing business in this state, or owning or using any part or all of its capital, plant, or any other property in this state[.]" In *Utelcom,* the two corporate taxpayers owned limited partnership interests in three limited partnerships that provided telephone service in Louisiana. Applying the rule that taxing statutes are to be interpreted liberally in favor of the taxpayer and against the taxing authority, the court rejected the Louisiana Secretary of Revenue's attempt to impose the franchise tax on the corporations. It specifically noted that under Louisiana law, "the franchise tax is imposed only on a corporation, 'owning or using any part or all of its capital, plant or other property in [Louisiana] in a corporate capacity.' No mention is made of the use of capital through a partnership or in any other indirect capacity." *Utelcom,* 77 So.3d at 49.

The Director's Arguments

The Director cites a previous decision by this Commission, *MRI Northwest Rental Investments I, Inc. v. Director of Revenue,* No. 01-1817 RV (Nov. 13, 2002), in which we calculated an out-of-state corporate taxpayer's franchise tax by including the net worth of its interest in a partnership that operated in Missouri. But, as Petitioner points out, neither the parties nor this Commission addressed the issue of whether the corporation could be taxed on the value of assets held in a partnership, only the proper valuation of the assets – because the

taxpayer conceded it was subject to the franchise tax. Even if the decision squarely addressed the point at issue in this case, our decisions lack precedential value. *Central Hardware Co. v. Director of Revenue*, 887 S.W.2d 593, 596 (Mo. banc 1994).

The primary basis for the Director's argument that Petitioner should be taxed on the value of LP's assets is that Missouri adheres to the common law "aggregate theory of partnership," which considers a partnership to be no more than an aggregation of individual partners. *Unifund CCR Partners v. Kinnamon*, 384 S.W.3d 703, 705-06 (Mo. App. W.D. 2012). This is a common-law rule, unchanged by Missouri's adoption of the Uniform Partnership Act. *Id.* The aggregate theory of partnership contrasts with the "entity theory," which characterizes a partnership as a separate entity. *Rhone–Poulenc Surfactants and Specialties, L.P. v. Com'r of Internal Revenue,* 114 T.C. 533,539 (No. 2125-98, June 29, 2000). Thus, the Director argues, the property and activities of the partnership should be treated as the property and activity of the partners – and since Petitioner is a partner, it should be liable for the franchise tax based on LP's assets in Missouri. The Director also cites § 358.250.1, which provides that a "partner is co-owner with his partners of specific partnership property holding as a tenant in partnership."

Unifund Partners dealt with a general partnership's capacity to sue a debtor. The court agreed that under the aggregate theory, a general partnership has no authority to sue in the firm name alone. 384 S.W.3d at 706.[13] Indeed, capacity to sue is the subject of most of the reported cases discussing Missouri's adherence to the aggregate theory of partnership. *See, e.g., McClain v. Buechner,* 776 S.W.2d 481, 483 (Mo. App. E.D. 1989); *N.E. & R. P'ship v. Stone,* 745 S.W.2d 266, 266 (Mo. App. S.D. 1988). We have not found a Missouri case that discusses the aggregate theory of partnership in relationship to tax laws.

[13] Although the court held that Unifund's incapacity to sue in its own name did not void the default judgment it obtained against a debtor in the case. 384 S.W.3d at 709. Because the issue was one of capacity rather than standing, it was waivable and not jurisdictional. *Id.*

In addition, Unifund Partners was a general partnership. Here, we are considering a limited partnership. Section 359.081 expressly provides that a limited partnership is an entity with legal capacity to sue and be sued *in the partnership name*. Thus, whether or not Missouri adheres to the aggregate theory of partnership, the general assembly has seen fit to modify some of the common law rules by statute in the Missouri limited partnership act. As another example, all partners to a general partnership are jointly and severally liable for the debts and obligations of the partnership. § 358.150.1. But a limited partner is not liable for the obligations of the limited partnership by reason of its being a limited partner, even if it participates in the management or control of the business. § 359.201. In other words, a limited partnership is a separate and independent legal entity in some ways that a general partnership is not.

The Director also cites *Acme Royalty Company v. Director of Revenue,* 96 S.W.3d 72 (Mo. banc 2002), an income tax case. Acme Royalty Company had an exclusive licensing contract with Acme Brick Company ("ABC"). *Id.* at 73. Both companies were Delaware corporations. *Id.* Acme owned the trademarks used by ABC, and ABC paid royalties to Acme for the use of the trademarks, either directly or to a limited partnership in which Acme was a 99% limited partner. *Id.* at 74. The Director audited ABC, a Missouri taxpayer, and learned of the existence of Acme. He then issued notices of deficiency to Acme, assessing income tax based on Acme's receipt of royalties from ABC. *Id.* The Supreme Court found that Acme had no Missouri source income because it had no sales in Missouri. While Acme was "related" to ABC, it was a separate legal entity. The Court held that Acme had no property, payroll, or sales in the state of Missouri, and no sales in Missouri. *Id.* at 75. Hence, it had no contact within the state, and no Missouri income.

The Director cites *Acme Royalty* to support his argument that the aggregate theory of partnership may be applied in the taxation context. He points out that the Court made no attempt

to distinguish the activities of the limited partnership from those of its partners in the decision. But he ignores the larger point: the fact that in *Acme Royalty*, the court rejected an attribution theory similar to the one he advocates in this case, to find that an out-of-state company whose income was largely generated in Missouri through an affiliated company was not subject to tax on that income.

There is certainly some logical support for the Director's argument. As the dissent in *Acme Royalty* pointed out, the companies that made and sold the products were located in Missouri, but they paid the royalties to their related corporation in a state with no income tax.

> This certainly is clever, but it is absurd to say that Missouri cannot tax the income derived from economic activity conducted on behalf of these "taxpayers" in this state. The income is, in the words of section 143.451.1, "derived from sources within this state." There is nothing in the record seriously to suggest that this corporate reorganization is for some legitimate purpose other to disguise the fact that this income from the manufacture and sale of the taxpayers' products in Missouri is subject to Missouri taxation.

Id. at 77.

In a similar vein, it seems incongruous to allow Petitioner to escape the franchise tax in this situation, particularly when § 147.010 reflects the general assembly's evident intent to capture income earned in Missouri by out-of-state corporations. But the general assembly did *not* amend the franchise tax statute to capture assets owned or employed by a limited partnership operating in Missouri, even if its partners are corporations.

This is a case in which the rules of construction matter. While the general assembly evidently intended to impose the franchise tax on foreign corporations employing their assets to do business in Missouri – which Petitioner in this case has done – it did not explicitly do so with respect to a corporation that does so through its interest in a limited partnership. We must

construe the law imposing the franchise tax strictly against the Director and in favor of the taxpayer. That being the case, Petitioner is not subject to the franchise tax.

Summary

Petitioner is not liable for franchise tax for 2003, 2004, and 2005.

SO ORDERED on December 10, 2013.

\s\ Karen A. Winn
KAREN A. WINN
Commissioner